Before the
Federal Communications Commission
Washington, D.C. 20554

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| In the Matter of | ) | |
| | ) | |
| Implementation of the | ) | CC Docket No. 96-150 |
| Telecommunications Act of 1996: | ) | |
| | ) | |
| Accounting Safeguards Under the | ) | |
| Telecommunications Act of 1996 | ) | |

REPLY OF SBC COMMUNICATIONS INC.

SBC Communications, Inc. ("SBC") hereby replies to certain oppositions to its Petition for Reconsideration (the "Petition") of the Report and Order[1] in the above-captioned proceeding.

I. THE SUBSTITUTION OF "CARRIER" FOR "REGULATED ACTIVITY" THROUGHOUT SECTION 32.27 WAS CLEARLY AN UNWARRANTED RULE CHANGE.

Despite the fact that changes were made throughout Section 32.27 to eliminate all references to "regulated activity," MCI claims that this did not "represent[] a rule change."[2] The language of the rule obviously did change, even if MCI chooses to ignore the differences between the old and the new Section 32.27.

MCI reasons that the Commission has always intended that Section 32.27 apply to all transactions between a carrier and its nonregulated affiliates. However, if the affiliate transaction rules were always applicable to all transactions, then it would not be necessary to amend the language of Section 32.27 to make it applicable to "all transactions." The Report and Order repeatedly states the Commission's conclusion that "[it] must apply [its] affiliate

[1] FCC 96-490, released December 24, 1996.

[2] MCI Opposition at 4-5.

transaction rules to all transactions."[3] If the affiliate transaction rule did apply to "all transactions" prior to the Report and Order, it would not have been necessary for the Report and Order to base its decision on a need to apply those rules to "all transactions" and it would not have been necessary to revise Section 32.27. By revising Section 32.27 and indicating that the intent in doing so is to make Section 32.27 applicable to "all transactions," the Commission admits that Section 32.27 was not applicable to "all transactions" previously. As argued in SBC's Petition, it is redundant and unnecessary to apply the affiliate transaction rules to a carrier's performance of nonregulated activities on behalf of a nonregulated affiliate.

MCI in fact claims that the Commission has "consistently emphasized that Section 32.27 applied to all transactions . . .."[4] On the contrary, until the Citizen CAM proceeding, the Commission's rulings indicated that Section 32.27 did not apply to transactions between a carrier's nonregulated activities and its nonregulated affiliates. For example, in CC Docket No. 86-111, the Commission stated that the affiliate transaction rules are applicable to transfers "in or out of regulation."[5] Further, one of the first rulings to focus directly on this issue stated as follows:

> We also conclude that MCI's claim that United is engaged in an affiliate transaction that is not listed in the manual is without merit. United's use of a

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[3] Report and Order, ¶¶ 252, 253, 254, 256; see also id. ¶ 103.

[4] MCI Opposition at 4.

[5] Joint Cost Order, ¶296. A number of other similar statements were made by the Commission in CC Docket No. 86-111. See, e.g., Joint Cost Order, ¶287("transfers between the regulated and unregulated sectors of a regulated company"); ¶294; ¶298("transfers between the regulated entity's regulated and nonregulated accounts"); n.471("assets transferred in and out of regulation"); Joint Cost Reconsideration Order, ¶115("transfers out of regulation to affiliates"); ¶116("assets transferred into regulation"); ¶117("asset transferred into regulation"); ¶121("transfers between regulated and nonregulated accounts").

> sales agency agreement is permissible under our rules, and United has listed this in its manual as a nonregulated activity and has treated it accordingly.[6]

As of September 1991, it was clear that the Commission was not applying the affiliate transaction rules to United's performance of a nonregulated marketing service for US Sprint. In effect, the initial ruling indicated that the affiliate transaction rules were not applicable and the sales agency service did not need to be listed as an affiliate transaction in United's CAM. The next ruling concerning United's CAM retreated from this position. Following SWBT's petition for reconsideration, the third ruling in the 1992 United Order indicated that, while the transaction must be listed in the CAM, "when a carrier provides a nonregulated service to its affiliate and records the transaction in a nonregulated revenue account [such as Account 5280-Nonregulated Operating Revenue], § 32.27 does not apply."[7] The most recent rulings in the Citizens CAM proceeding recharacterize the 1992 United Order as referring only to nonregulated activities accounted for on a "separate set of books" even though the 1992 ruling makes no reference whatsoever to a "separate set of books."[8] Obviously, the history of the rulings concerning the United CAM are far from consistent with the view that Section 32.27 applies to this type of transaction. In fact, the Commission's rulings lead one to the opposite conclusion.

Now that the Report and Order changes the language of Section 32.27 to effectuate the

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[6] United Telephone System Company's Permanent Cost Allocation Manuals For the Separation of Regulated and Nonregulated Costs, AAD 90-22, 6 FCC Rcd 5235, 5236, ¶ 8 (1991).

[7] In the Matter of United Telephone Systems Companies' Permanent Cost Allocation Manuals for Separation of Regulated and Nonregulated Costs, 7 FCC Rcd 4370 ¶ 12 (1992).

[8] Citizens Utilities Company Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, AAD 94-6, Memorandum Opinion and Order, 11 FCC Rcd 4676 (1996) review denied, Order on Review; FCC 97-33, released February 6, 1997 ¶¶ 10-13.

interpretation in the Citizens CAM rulings, the Commission should review, and seek public comment on, the issues presented in that proceeding in order to assess whether this rule change is justified. SBC maintains that this rule change is not justified. In view of the fact that Part 64 provides sufficient protection against cross-subsidy by removing from the regulated jurisdiction all of the costs of the nonregulated activities listed in Section II of each carrier's CAM, Section 32.27 should not apply to a carrier's performance of nonregulated activities on behalf of a nonregulated affiliate or vice versa.[9]

## II. DESPITE AT&T'S MISPLACED OBJECTIONS, IT IS INCONSISTENT WITH PART 64 TO CLASSIFY TARIFFED INCIDENTAL INTERLATA SERVICES AS NONREGULATED SOLELY FOR FEDERAL ACCOUNTING PURPOSES.

In its Opposition, AT&T mischaracterizes SBC's position concerning the federal accounting classification of incidental interLATA services. AT&T claims that SBC's position is "that those incidental interLATA services which are common carrier services should be treated as regulated for federal accounting purposes. This would exempt such services, including commercial mobile radio services ('CMRS'), from the cost allocation rules altogether."[10] AT&T also contends that "incidental services including CMRS and video dialtone are fertile areas for cross-subsidization, thus making greater accuracy in accounting safeguards essential. Moreover, the Commission has previously required AT&T to treat its wireless services as nonregulated for federal accounting services."[11] Contrary to AT&T's misapprehension, SBC's Petition did not

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[9] Similarly, use of a fair market value method for services is not necessary because fully distributed costing provides sufficient protection. Therefore, SBC supports Ameritech's proposal to establish a minimum threshold of $250,000 for requiring a fair market value study for services. Response of Ameritech to Petitions for Reconsideration, at 5.

[10] AT&T Opposition at 2.

[11] Id. at 3.

request that CMRS or other wireless services licensed under Title III of the Communications Act be reclassified as regulated. SBC's Petition was focused on those Title II common carrier communications services that the Commission has traditionally treated as regulated activities for federal accounting purposes. These are the common carrier services that have been subject to full Title II regulation. In its Petition, SBC did not question the Commission's previous decisions to treat CMRS and other Title III services as nonregulated for federal accounting purposes.[12] Rather, SBC questioned the decision to assign a nonregulated accounting classification to those incidental interLATA services that the Commission continues to fully regulate under Title II. For example, the interLATA signalling services allowed by Section 271(g)(5) should not be given nonregulated accounting treatment if the Commission is going to require that such services comply with the full range of Title II regulation, including tariffing.[13]

AT&T has misinterpreted SBC's position as arguing that CMRS and other Title III wireless services should be classified as regulated. In fact, SBC pointed out that "each type of incidental interLATA service listed in Section 271(g) is either regulated or nonregulated. If it is nonregulated, such as video programming or an information service, then Part 64 will fully

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[12] See, e.g., Eligibility for the Specialized Mobile Radio Services and Radio Services in the 220-222 MHz Land Mobile Band and Use of Radio Dispatch Communications, GN Docket No. 94-90, Report and Order, 10 FCC Rcd 6280, 6293-94 & n.77 (1995); Request of US West Communications, Inc. for a Limited Waiver of Section 22.903 of the Commission's Rules, 11 FCC Rcd 10905, 10916 ¶24 (1996).

[13] SBC is also baffled by AT&T's suggestion that SBC's Petition proposed to "exempt" CMRS "from the cost allocation rules altogether." Regulated accounting classification of a service would not exempt it from any cost allocation rules, but SBC did not propose regulated accounting classification for CMRS in any event. However, even those regulated Title II common carrier services that are fully subject to Title II regulation would not be exempt from the cost allocation rules in Parts 64, 36 and 69.

allocate the underlying costs . . . ."[14] SBC's Petition could have included CMRS as another example of an interLATA nonregulated services authorized by Section 271(g).

Consistent with Part 64 precedent, if a nonregulated mobile radio service is provided on an interLATA basis, the underlying costs will be fully allocated to nonregulated activities and any tariffed services will be charged to the nonregulated activity at tariffed rates. However, it is not necessary or appropriate to presume that tariffed incidental interLATA services are nonregulated for accounting purposes. They should be treated as regulated to be consistent with the original framework of Part 64.

AT&T's concern about nonregulated wireless services such as CMRS is clearly misplaced. Likewise, AT&T's reference to "video dialtone" is in error, given that "video dialtone" no longer exists, as a result of the 1996 Act.[15] In any event, if AT&T intended to refer to video programming, those activities most likely will be conducted under Title VI of the Communications Act, and thus, they would also be considered nonregulated under Title II. Moreover, a separate pending proceeding, CC Docket No. 96-112, is considering the necessity of any additional safeguards for LECs' integrated provision of video programming. Therefore, any specific concern AT&T has concerning video programming should be addressed in that proceeding rather than as a misplaced objection to SBC's well-founded arguments concerning incidental interLATA services.

As SBC explained in its Petition, it is unnecessary to presumptively misclassify regulated incidental interLATA services as nonregulated for federal accounting purposes. The

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[14] SBC Petition at 9.

[15] Pub. L. No. 104-104, § 302(b)(3), 110 Stat. 56 (1996).

Commission should classify regulated incidental interLATA service costs consistent with the original intent of Part 64, as expressed in the Joint Cost Order. The cost of such regulated incidental interLATA services should be allocated as regulated through Part 64, separated into state and interstate through Part 36 and allocated to the interexchange price cap basket through Part 69. Parts 36 and 69 of the rules are the proper mechanisms for separating regulated incidental interLATA costs from local exchange and exchange access costs. To the extent the Commission finds that there are deficiencies in Parts 36 and 69 that the Commission believes will not provide adequate assurance against cross-subsidy, the Commission should adopt the necessary corrections to the Part 36 and Part 69 rules, instead of patching the holes in Parts 36/69 with cloth of a different nature altogether.

## III. SECTION 61.45(d)(1)(v) WAS ONLY INTENDED TO GIVE EFFECT TO SECTION 64.901(b)(4)'s NETWORK INVESTMENT FORECASTING RULE.

Cox and MCI claim that it is consistent with price cap regulation for regulated prices to decrease each time a carrier provides a new nonregulated product. However, according to the Commission, price cap regulation was intended to "mov[e] away from a system in which regulators dictate prices on the basis of fully distributed costing principles."[16] In addition, one of the supposed benefits of price cap regulation was that it would provide efficiency incentives, including "the incentive to provide more services, to the benefit of ratepayers."[17] Repeated application of the exogenous cost rule each time a new network product is introduced is contrary to both of these principles.

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[16] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd 6786 ¶35 (1990).

[17] Id.

MCI also questions the logical connection between Section 61.45(d)(1)(v)'s "reallocation of investment from regulated to nonregulated activities" and Section 64.901(b)(4)'s "allocation of central office equipment and outside plant investment costs between regulated and nonregulated activities . . . based upon . . . the investment usage forecast." The only reference to investment in Section 64.901 is subsection (b)(4). This is obviously the investment reallocation principle intended by the reference to investment in Section 61.45(d)(1)(v).[18] In adopting Section 61.45(d)(1)(v), the Commission also referenced the investment forecasting rule as the pertinent Joint Cost rule.[19] Specifically, the Commission stated that it needed to adopt an exogenous cost rule to give effect to the Joint Cost rules and the only requirement of the Joint Cost rules that it referenced as being effectuated by this exogenous cost rule was the investment forecasting rule codified in Section 64.901(b)(4).[20]

While MCI does not dispute the fact that price caps were established based on investment as of 1990, MCI claims that the placement date of the investment is irrelevant because new investment allegedly affected the revised productivity factors adopted in 1995.[21] The fact that investment was placed after 1990 is certainly relevant because rate recovery for prudent investment prior to 1991 was explicit under rate-of-return regulation. By contrast, under price cap regulation, rate recovery for new, prudent investment was not guaranteed. Moreover, contrary to MCI and AT&T's conclusory argument, post-1990 investment played no part in

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[18] SBC explained this logical connection in more detail in its Petition. Petition at 10-12.

[19] 1990 Price Cap Order, 5 FCC Rcd at 6807-08 ¶171-172.

[20] Id. As noted in SBC's Petition, the Commission subsequently applied Section 61.45(d)(1)(v) in this manner. SBC Petition at 13-14.

[21] MCI Opposition at 6(citing AT&T Comments as its only authority).

setting the interim productivity factors in 1995.[22]

Despite these and other arguments by Cox, MCI and others, the Commission should interpret Section 61.45(d)(1)(v) consistent with the price cap rules to apply only as necessary to enforce Section 64.901(b)(4)'s requirement to allocate network investment based on the peak relative nonregulated usage over a three-year forecast period.

[22] First Report & Order, CC Docket No. 94-1, 10 FCC Rcd 8961 ¶¶208-214 (1995)(Elimination of the 1984 data point was the only correction in the 1995 factors.).

For the foregoing reasons, the Commission should reject the objections to SBC's Petition and grant the relief requested by SBC therein.

Respectfully Submitted,

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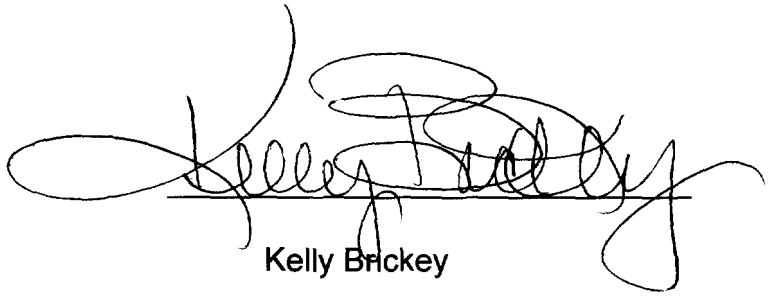
## CERTIFICATE OF SERVICE

I, Kelly Brickey, hereby certify that the foregoing " Reply of SBC Communications Inc.", has been served April 16, 1997, to the Parties of Record.



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